

## **Getting new regulatory policy done:**

### **Crowdfunding commercial real estate in the USA**

A historical case study with a cotemporary challenge

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#### **Background**

Governments continually need to update policies, especially when faced with changing opportunities or threats. The process of getting policy adjustments done can be difficult, however, especially when an historic policy context already exists. The process can be informed by outside experiences but is often dominated by domestic considerations. This case tells a story about policy change in the United States of America (USA), focused on regulatory reform in the securities market designed to allow democratization of the financial sector through crowdfunding. It explores the potential influence on this policy change process of recent crowdfunding innovation in Colombia, asking how policy initiatives in the traditionally less developed global south might have an affect on policy changes in the more developed north.

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## **Common capital market regulations; and crowdfunding**

Securities markets play a central role in any economy. Businesses and developers use such markets to obtain finance; individuals and institutions use the markets to find investment opportunities. These engagements tend to be highly regulated, with regulations focused on the joint goals of capital formation and investor protection. The most important of these regulations in the United States date back to the 1930s and include the Securities Act (1933) and Securities Exchange Act (1934). These regulations impose rules on firms trying to issue securities, limit the access of less well off and potentially vulnerable investors (called “unaccredited” in the laws) to risky ventures, regulate the entities that can trade in securities markets (like banks and investment brokers), and formalize the role of administrative organizations overseeing these markets—like the Securities and Exchange Commission (SEC).

According to the rules, those trying to obtain finances from the general public must satisfy costly registration requirements and work through intermediaries (like banks and investment brokers) that ensure potential investors are qualified to participate. These rules make it difficult and costly for businesses to raise money directly from most common citizens (called “unaccredited” in the legislation) and keep most of these common citizens from investing directly in the vast majority of business initiatives. This legal firewall does not exist for private financing routes one can take when dealing with wealthier investors, however (those called “accredited” in the legislation). Businesses and developers can go straight to such individuals and organizations in search of finance and receive support with significantly lower barriers. This results in many new, high return opportunities in the USA being financed by the wealthy; and the wealthy enjoying almost exclusive access to the proceeds from such opportunities.

These rules have not always been in place, however. History offers many examples of businesses raising money directly from a large number of individual investors for a specific activity. A prominent example saw Joseph Pulitzer raise thousands of small donations to finish the Statue of Liberty in 1884. Pulitzer used

his newspaper to advertise the initiative and received money from investors without having to work through an intermediary and without having to follow rules that excluded some from the venture. This fundraising approach is an example of 'crowdfunding', which simply involves one entrepreneur or developer selling a stake in a project to many members of a crowd of investors, through a public platform (the newspaper, in this case) for some kind of reward (tangible or intangible, financial or non-financial).

Research suggests that crowdfunding attracts certain types of 'crowd' investors who engage in ways that yield important benefits for the projects; including investor protection.<sup>i</sup> Studies reflecting on the psychology of 'the crowd' show that investors who use this approach tend to be innovative and prefer investing in specific initiatives that they can identify with. The engagement of such individuals influences the ultimate value of the offerings and the outcomes of the process. Each individual acts as an agent of the offering, selecting and promoting the projects in which they believe. They will sometimes provide help on projects (identifying and designing projects and ensuring the projects progress and meet objectives). They will also disseminate information about projects they support in, generating further support and promoting transparency around the project and accountability for its progress. Motivation for participation stems from the desire to be at least partly responsible for the success of others' initiatives, to be a part of a communal social initiative, and to invest in a profitable venture that might otherwise be inaccessible.

### **The internet, crowdfunding exemptions, and the JOBS Act**

The internet affords many more entrepreneurs and developers access to crowds today than was the case in Joseph Pulitzer's 1884. This technological innovation opens the way for using crowdfunding expansively in the USA, drawing on vast crowds to engage in building the country's economy. Thousands of individuals and firms have already used this platform to raise funds. Companies like Indiegogo and Kickstarter have shown that this platform is effective in raising significant amounts

for creative projects and causes. As of January 2014, over 200,000 funding campaigns had been launched on Indiegogo alone.<sup>ii</sup> Kickstarter claims to have raised more than \$1 billion from 5.7 million donors to fund 135,000 projects (including films, music, stage shows, journalism, video games, and food-related projects).<sup>iii</sup> Investors in these projects have typically received non-financial returns for their contributions, including visits by celebrities, access to concerts or even cupcakes.

Regulations have limited the use of this approach in respect of more common securities trade, however, where investors receive financial returns for the financial contributions they make (Given that a security is defined as ‘an investment of money in a common enterprise with profits to come solely from the efforts of others . . . whether the enterprise is speculative or non-speculative or whether there is a sale of property with or without intrinsic value’<sup>iv</sup>). The 1930s laws (and others) constrain firms and developers from selling equity in a project or initiative to a crowd of investors via the internet [see Annex 1 for a brief discussion of key laws].

Some entrepreneurs (including Profounder.com, Propser.com, and Buyabeer.com) have attempted to bypass these laws in the past and sell equity directly through the internet. They were issued cease and desist orders by the SEC for their efforts.<sup>v</sup> These efforts drew high-level attention to both the opportunities of internet-based crowdfunding and the constraints of such, however. This attention led to a *Crowdfunding Campaign to Change Crowdfunding Law* in 2010 and proposals for formal policy change in 2011. These proposals came from members of the House and Senate (in both Democratic and Republican Parties) who offered various pieces of legislation focused on creating a regulatory exemption for crowdfunded securities and democratizing the way investments are obtained [Annex 2 shows a timeline of efforts to promote crowdfunding exemptions].

These proposals led to the April 5, 2012 signing of the *Jumpstart Our Business Startup Act* (also called the ‘JOBS Act’), which paved the way for widespread use of the internet in raising money for small firms and developers of commercial projects. In introducing the law, President Barack Obama noted that, “Because of this bill,

start-ups and small businesses will now have access to a big, new pool of potential investors—namely, the American people. For the first time, ordinary Americans can go online and invest in entrepreneurs they believe in.”<sup>vi</sup> The Act opened these opportunities in a number of ways [described briefly here but with more detail in Annex 3, which also reflects on other aspects of the JOBS Act]:

- Title II expanded opportunities for businesses to access money from wealthy (“accredited”) investors without having to comply with onerous regulations (given an exemption under Regulation D, Rule 506c of the Securities Act), by allowing mass marketing of offerings—including via the internet (provided issuers take reasonable steps to ensure buyers are accredited).
- Title IV (also called Regulation A+) increased the amount that small businesses could raise from accredited *and* unaccredited investors (on the internet and elsewhere) using only a mini-registration (under the Regulation A exemption of the Securities Act) from \$5 million to \$50 million in a twelve-month period (provided investors receive certain filings and audited financial statements are produced by the businesses, and with businesses also registering at the state level).
- Title III—also known as the ‘crowdfunding provision’—allows companies to raise up to \$1 million every year from the general public through a broker-dealer or ‘funding portal’ website without registering through onerous processes. Investors are subject to annual caps based on their income and wealth and there are investor education requirements, standard financial reporting requirements and limits on advertising, but this title offers the most direct way to raise funds from the broad crowd ever proposed in the USA.

### **But there is an ongoing failure to ‘get rules done’**

All three of these titles required SEC rulemaking before they could ‘go live’ (and actually be implemented). This rule-making was meant to be completed by January

5, 2013 (270 days after enactment), but has taken much longer than expected. Title II rules were finalized on September 23, 2013, which resulted in the lifting of the 1933 ban on general solicitation of private offerings in September 2013 (and meant that firms could reach out to wealthy investors via the internet). Title III and IV rules were passed at the same time but had still not finalized in mid 2014, however (at the date of writing this case). Proposed rules for Title IV were issued on October 23, 2013 [See Annex 4], and comments on these proposed rules were received in February 2014, with an SEC committee issuing recommendations based on these comments in April 2014, but no rules have been forthcoming since that time. This means that rules are still not finalized over two years after enactment of the JOBS Act (and over eighteen months after these rules were due to be finalized, by law). The result is that Titles III and IV are not operational yet, and entrepreneurs and developers still have no way of engaging in broad-based crowdfunding or using the internet (or other means) to reach out to ordinary investors (especially those who are not wealthy, or “unaccredited”).

On April 28, 2014, SEC Chairwoman Mary Jo White defended the slow pace of rulemaking and suggested that her commission of administrative regulators was still struggling with its thinking on how to protect investors in a crowdfunding world. She noted that “[O]ne has to always have investor protection in mind when you do any kind of capital formation for the sake of the investors and for the sake of the credibility of the method you are using to raise capital.”<sup>vii</sup> This emphasis on investor protection is reflected in reports suggesting that the commission is taking a conservative approach to making rules, siding with state regulators who voiced concern over Title III.<sup>viii</sup> These reports reflect on emerging recommendations from the SEC that ensure hard safeguards will exist for investors in any crowdfunding paradigm<sup>ix</sup> [see Annex 5 for details on recommendations emerging from the SEC Investor Advisory Committee after receiving comments on proposed regulations]. These safeguards would essentially retain (and even strengthen) the rigid limits currently in Title III; limiting contributions by investors and the amount of money entrepreneurs and developers can raise, requiring the use of highly regulated

crowdfunding portals, and forcing compliance with various rigorous administrative requirements. Critics of such approach argue that the proposed safeguards will increase the cost of raising capital via crowdfunding.<sup>x</sup> Some calculate that the fees of broker-dealers, lawyers and accountants required by SEC regulations will range between \$100,000 and \$250,000—a 10 to 25% cost of capital, given that the proposed maximum a firm will be able to raise is \$1 million per annum. Many suspect that this high cost of capital will result in few firms using Title III crowdfunding if and when it is finally allowed.

The SEC's cautious approach reflects many voices inside Congress and (especially) views in the professional regulatory community. For instance, Senator Jeff Merkley (D-Ore.) has called for the SEC to limit investment by non-accredited investors to just \$2,000. The North American Securities Administrators Association also has a conservative view on the topic. It has called on the SEC to require crowdfunding portals to pre-screen each investor, and to cap the size of investments an individual investor can make in much the same way as Senator Merkley proposes.<sup>xi</sup> This caution reflects fear on the part of many regulators that crowdfunding will yield high levels of fraud; a fear that is not open to real assessment at present but which popular media suggests has no real merit given past experiences with non-financial crowdfunding.<sup>xii</sup> Elements of this cautious approach are also evident in the few State regulations that currently allow crowdfunding (or that propose such), but most of these state regulations are generally more balanced than the federal version seems to be—having either higher caps on the allowed investments or lower levels of red tape (both resulting in lower costs of capital) [See examples in Annex 6].

There are many who do not agree with the cautious approach, however, and are frustrated over the slow pace of rule-making and the constraints that still seem to characterize crowdfunding rules. One of these dissenters was an early supporter of the JOBS Act, Representative Patrick McHenry (R., N.C.). He has gone as far as to suggest a new law to replace Title III. He calls it the “Equity Crowdfunding

Improvement Act of 2014" which would increase the amount a private company could raise under equity-based crowdfunding (from \$1 million from \$5 million) and boost the amount entrepreneurs could raise without providing audited financial statements (from \$500,000 to \$3 million). The blend of a higher cap and lower red tape is intended to reduce the cost of raising capital via crowdfunding, making such more attractive to entrepreneurs and developers.

### **Crowdfunding progress and potential in the commercial real estate sector**

The impasse over crowdfunding rules has generated frustration beyond politics too, especially affecting firms that invested in setting up to respond to the crowdfunding provisions in the JOBS Act. The commercial real estate sector has been a particularly active area for such firms, which include the Prodigy Network, EarlyShares.com, Fundrise, Realty Mogul and RealtyShares.<sup>xiii</sup> These firms have moved ahead to pursue crowdfunding in the real estate market given the view that this market involves the sale of tangible assets that people in the crowd can look at and even visit and that are easier to understand and value than many other entrepreneurial options targeted by the JOBS Act, like technology startups (given that real estate offers a clearly defined form of collateral, cash flow, return and exit time for investors).<sup>xiv</sup>

Given the failure to get things done with the Title III and Title IV JOBS Act rules, these firms have been forced to limit their crowdfunding activities to Title II deals involving wealthy, accredited investors accessed through general solicitation (including via the internet). Whereas official data on the amounts raised are not yet available, press releases suggest that over \$135 million was raised by these firms through such means in the first half of 2014 alone [see Annex 7 for examples].<sup>xv</sup> This shows the potential for dynamic fundraising in the new, open legislative environment. Crowdfunding under Title II (the limited version) is already engaging more investors and opening new avenues to finance commercial real estate.

Many observers believe the potential to raise capital in this manner and engage more investors in commercial real estate is even greater when it comes to “unaccredited” investors.<sup>xvi</sup> These individuals, with net worth lower than \$1,000,000 and incomes under \$200,000, have typically had less exposure to commercial real estate than higher wealth (accredited) individuals. Data show that the wealthiest ten percent of Americans own about 80% of non-home real estate and that wealthy individuals are highly likely to own commercial real estate (76% of the richest 1% of these individuals are estimated to own commercial real estate, for instance, as are about 50% of those in the next richest 19%).<sup>xvii</sup> In contrast, the vast numbers of “unaccredited” American investors own very small amounts of non-home real estate (less than 5%), and very few of these investors (estimated at fewer than 10%) have commercial real estate assets in their portfolios.<sup>xviii</sup>

The low level of engagement by unaccredited investors should not lead one to believe that commercial real estate is a ‘bad’ asset for them to hold. In fact, direct holdings of non-home assets are considered extremely positive in any investment portfolio. These holdings help to diversify portfolios, offer inflation protection, and provide a better risk adjusted investment than many other options in the market—often with lower volatility.<sup>xix</sup> Investors in commercial real estate can also achieve returns from both income yield and asset appreciation.

Commercial real estate ownership is often difficult for smaller investors to attain because of the large financial outlays needed, however. Smaller investors lack the capital to buy-into high value investment grade commercial real estate deals (like hotels and shopping malls) that commonly yield the highest return, and struggle to even find ways of investing in lower value projects (like multi-family housing units, which often also require millions of dollars of financing).<sup>xx</sup> Financing options currently in place tend to create barriers for lower-income investors to pool resources effectively and invest in such opportunities. Mechanisms like Real Estate Investment Trusts (REITs) do allow all investors some access to the market through pooling, but these are more like real estate mutual funds (with similar risk-return

profiles and management costs as other mutual funds) and do not give investors access to the benefits of direct investment in actual real estate (like hotels or multi-family units).<sup>xxi</sup> As a result, organizations like the Pension Real Estate Association advocate having both REITs and direct real estate holdings in a portfolio.<sup>xxii</sup>

Advocates argue that crowdfunding is a vehicle that can allow all investors access to direct real estate holdings.<sup>xxiii</sup> This access is already a reality in some contexts, with the recent experience in Colombia standing out for attention. This experience centers on the engagement of a firm called Prodigy Network, which also trades in the USA (as shown in Annex 7), and its founder and CEO Rodrigo Niño.<sup>xxiv</sup> Niño has seen the way crowdfunding can mobilize broad-based investment participation in a safe and effective manner, from a broad crowd of all kinds of investors. His company raised \$190 million between 2009 and 2013 to help finance the building of BD Bacatá, which will be the tallest skyscraper in his native Colombia when completed in 2015 (and is the first skyscraper built in Colombia in over 40 years).<sup>xxv</sup> The money was raised from over 3,950 investors who made a minimum contribution of only \$20,000 (which would equate with about 10% of the annual income of an “unaccredited” investor earning \$200,000). Most of the investors engaged in this project would not have been allowed to participate in the USA, even under new Title II deals, because they would not qualify as “accredited” or they would have had their contributions capped. The entire projects would also have been prohibited in the USA given the regulative proposals to cap fund raising potential to \$1 million per annum.

The BD Bacatá project is already in process, however, given a more open regulatory regime in Colombia. Investors have already seen returns as well, on par with those from the commercial real estate market in Colombia. Beyond these returns, these investors are now part-owners of an investment grade property—a skyscraper in downtown Bogotá. The success of this venture has given the Prodigy Network real legitimacy and resulted in additional crowdfunded projects in Bogotá. A crowd of more than 850 investors raised \$17 million in four months for an 8-story

luxury hotel for executives (EXE Bacatá 95), for instance, which opened its doors in the first half of 2014.<sup>xxvi</sup> A further \$14.5 million was raised from 484 small investors in three months to build the Airport Business Hub, which is an office complex close to El Dorado Airport.<sup>xxvii</sup> The crowd were also involved in informing the design at the Hub, with the Prodigy Network soliciting designs through an online architecture contest that attracted thousands of applications. The engagement of the crowd in this instance is intended to ensure high levels of participation in all aspects of the project and to promote transparency in the project implementation process (with the developers providing regular updates on building progress to the crowd).

### **The Colombian regulatory model that allows crowdfunding in real estate**

The Prodigy Network's experience with broad-based crowdfunding in Colombia has been facilitated by the country's approach to regulating access to finance in areas like commercial real estate. This approach is not like that which exists in the USA, shaped as this has been by the 1930s legislation that (i) controls access to securities investment opportunities (keeping apparently less sophisticated or "unaccredited" investors out of certain deals) and (ii) imposes costly red-tape on those looking to raise finance. The Colombian approach focuses instead on ensuring broad access to finance (or 'democratizing access' as stated in the Constitution<sup>xxviii</sup>) and fostering investor protection through mechanisms that promote transparency, accountability and integrity in the investment process. One of the ways it does this is by allowing businesses and developers to raise money through trusts instead of securities markets (hence avoiding costly registration and trading controls in the securities markets). This approach allows many individuals to buy trust partnerships and enjoy equity ownership and is the main vehicle through which companies like the Prodigy Network have pursued crowdfunding (given an absence of controls on who can invest, as partners, in trusts).

'Fiduciarias' are a key Colombian mechanism allowing this type of investment to work; and hence are vital when it comes to a discussion on crowdfunding in the country. These are third party trustees that are quite peculiarly

Colombian (not existing in the exact form anywhere else).<sup>xxix</sup> They act as intermediaries between entrepreneurs and developers trying to raise funds and members of the public looking to invest in productive initiatives. According to a recent World Bank report, fiduciarías have proved quite successful in playing this role, and “are perceived as a relatively efficient response to contract enforcement problems and general distrust concerns.”<sup>xxx</sup>

The role of the fiduciaria is entrenched in legislation and has been growing since the early 1990s [discussed briefly in Annex 8.] These entities are engaged in real estate crowdfunding initiatives by the developers themselves, who produce a detailed proposal of the project to start such engagement. The fiduciaria does a rigorous background check on the developer and reviews the project proposal. In such assessment, the fiduciaria will examine whether the developer is likely to receive licenses needed for construction (a process in which the developer’s experience is also reviewed) and also if the developer complies with the provisions of paragraph 5.2 of external circular 047 of 2008, which emphasizes the importance of “minimum levels of insolvency, technical, administrative, and financial capacity according to the magnitude of the project.”

If developers survive this scrutiny, the fiduciaries turn to a study of the business proposal (to further satisfy requirements in circular 047, which requires that the fiduciaries i) do the risk analysis of each Project; ii) have trust agreements appropriate to the specific business; and, iii) do a correct disclosure of information to the public on the scope and effects of its participation).<sup>xxxi</sup> This analysis informs the creation of a contract with the developer, detailing the financial needs of the project and a set of agreed-upon rules and conditions governing how and when finances will be disbursed. The contract emphasizes transparency, providing detail on all conditions and specifications of the project. The developer then advertises the project to potential investors, and these investors place their funds in trust with the fiduciaria. This trust is like an escrow account that the fiduciaria controls, releasing money towards project activities only when agreed-upon conditions are

met by developers. Money will usually start flowing when a minimum collection threshold is met, for instance, and only for specified activities. The fiduciaria will often employ auditors to oversee this process and may also hire building contractors and other specialists to help provide oversight and monitoring assistance in the case of real estate transactions.<sup>xxxii</sup>

About 2,000 real estate projects are developed using these kinds of fiduciaria-administered trust contracts every year in Colombia. This is because the contracts offer transparency and confidence to investors. Furthermore, the trust structure allows multiple investors to participate—which leads to bigger projects that would be out of reach of individuals investing alone. Financial institutions in the country are also supportive of these entities, typically approving trusts when deciding on mortgages or bank loans; because this structure fosters accountability (by separating developers and financiers). In addition, this mechanism is used to control the cash flow for the construction and development of the project, which often proves problematic during construction. This reduces risks of overspending in early periods of project adoption and ensures accountability in the project process. Finally, the cost of raising capital in this manner is considered low—at around one or two percentage points of the contractual amounts.

### **Is this an approach to get the USA policy change done?**

The Prodigy Network's pioneering experience with real estate crowdfunding in Colombia would not have been possible without the trust structure and fiduciaria mechanism in the country. These regulatory devices have allowed capital formation *and* investor protection through crowdfunding in Colombia without imposing rules on who can be in the crowd or on the size of investments; and without introducing expensive administrative rules and processes that inflate the cost of raising funds.

Prodigy's founder and CEO Rodrigo Niño believes this kind of structure can be used in the USA as well, and that this approach can help alleviate the current regulatory tensions that exist around the JOBS Act (and the struggles over the size of investment caps and such).<sup>xxxiii</sup> His company has pursued a variety of ventures in the

USA by blending ideas drawn from the Colombian experience with regulatory realities in the USA and new strategies that academics are suggesting to foster safe and effective crowdfunding. These ventures include multimillion-dollar projects in New York City (buying and developing buildings at 17 John and 84 William Streets in Manhattan). The projects were pursued by raising money from a crowd of foreign and domestic investors (taking advantage of Regulation S in the Securities legislation—that allows for foreign investors to engage with minimal regulation—and Title II of the JOBS Act—allowing “accredited investors” to participate in crowdfunding ventures). Two third party fiduciary companies were hired to manage the resources raised from the crowd and to foster transparency in both how the money is held (in escrow) and released (according to offering documents).<sup>xxxiv</sup> Prodigy has also used these projects to prompt discussion about ways of improving investor protections (requiring, for instance, that developers put money down first and only draw money out when certain conditions have been met).

These projects have also been used to experiment with new approaches to value crowdfunded real estate initiatives and communicate the peculiar risks and returns of such to potential investors.<sup>xxxv</sup> Niño has gone on record supporting the adoption of a hybrid commercial real estate regulatory structure employing third party trustees in the USA.<sup>xxxvi</sup> He argues that this kind of mechanism will open the way for commercial real estate to become a stand-alone asset class and even to the creation of an exchange where these assets are directly traded. In this respect, he offers Real Estate Partnerships (REPs) in the projects offered by Prodigy, which have been around for many years and are the equivalent of stocks in a specific company. He believes that the day will come when individuals can trade in REPs associated with many different real estate projects as freely as they do in stocks, buying into specific buildings or real estate opportunities through the crowd—with clear information about the value and risk and return profiles of these assets.

Niño’s vision is expansive and positive about the potential role of crowdfunding in fostering capital formation and the inclusion of lower-income

(“unaccredited”) investors into markets like that of commercial real estate. Other observers are less confident about the potential benefits of crowdfunding, however, as already discussed in this case. Some commentators have even been quite disparaging of the experience in Colombia or the idea that a global-South country like Colombia has any lessons to offer policymakers in the USA.<sup>xxxvii</sup> These commentators seem defensive about any approach that will loosen access of potentially vulnerable investors to new and untested parts of the market. They believe that crowdfunding should be highly regulated—in the spirit of existing Securities laws—and that access to markets through crowdfunding should be limited.

Many of these commentators have seen their voices reflected in the April 2014 recommendations on crowdfunding by the SEC investor advisory committee. As discussed, this committee voted unanimously to advise the SEC to stiffen its proposed crowd-funding rules, given voices of concern from committee members.<sup>xxxviii</sup> One of these members, Stephen Holmes (chief operating officer for venture capitalist InterWest Partners), said illiquidity and dilution will be factors in 99 percent of crowd-funding offerings. Another member, Damon Silvers (AFL-CIO associate general counsel) noted that deregulating crowdfunding will “cause a lot of problems that are unmanageable—a deregulated market place for investors with no sophistication.” These voices cause one to question whether there is any space for the USA to learn about policy change and regulation from another context like Colombia; or to explore the kind of policy changes that re-order how markets and societies work, given the potential of new technology like the internet.

- Based on this discussion, how far-reaching do you think the policy changes centered on introducing crowdfunding will be?
- In thinking about this, reflect on contextual factors that seem to be driving the policy review process (especially the factors that have held the process up, leading to a failure to ‘get new regulatory policy done’).

- Given the contextual factors that are at play in this policy adjustment process, what potential is there for an experience like that in Colombia to inform and influence the policy change process in the USA?
- Finally, how would you propose the SEC progress in taking steps to introduce new crowdfunding rules and give life to the JOBS Act?

## **Annex 1. Laws regulating the securities market in the USA**

A number of laws have been enacted since the 1930s to regulate the securities market in the USA. These include the following: The Securities Act of 1933; The Securities Exchange Act of 1934; The Trust Indenture Act of 1939; The Investment Company Act of 1940; The Investment Advisors Act of 1940; The Sarbanes-Oxley Act of 2002; The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010; The Jumpstart Our Business Startups Act of 2012.

Interestingly, the regulations listed above were mostly enacted in response to some kind of financial crisis and attempted to resolve some market weakness exposed by such crisis. For instance, the Securities Act of 1933 and the Securities Exchange Act of 1934 aimed to reform a securities industry that was considered out of control and was blamed for the Crash of 1929 and the Great Depression. The Investment Company Act of 1940 and the Investment Advisors Act of 1940 were similarly introduced to bring structure to a financial sector that expanded greatly after the depression was over, providing regulations to the many investment firms that began to proliferate. The Sarbanes-Oxley Act of 2002 was similarly a response to numerous corporate and accounting scandals, including those at Enron, Tyco, Adelphia, Peregrine System, and WorldCom. The 2008 financial crisis resulted in the Dodd-Frank Reform and Consumer Protection Act of 2010.

These legislative acts were generally intended to protect the public and have imposed more and more controls on the operation of firms in the securities sector, apparently placing more emphasis on investor protection than on capital growth (the two recognized goals of any securities regulation mechanisms). The JOBS Act in 2012 offered a break in this trend of restrictive regulation. It was introduced in the wake of the depression following the 2008 financial crisis and responded to the growing difficulties firms were having in raising finances for new business development. The Act sought to loosen previous securities regulations and to encourage small business growth and is also seen as a mechanism to modernize the financial sector (hence the crowdfunding initiatives).

## **Annex 2. A timeline of efforts to promote crowdfunding exemptions, to 2012**

- April 2010: Paul Spinrad (Make Magazine), Jenny Kassan (The Sustainable Economies Law Center, or SELC) and Danae Ringelmann (Indigogo) launch the Crowdfunding Campaign to Change Crowdfunding Law. The goal was to fund the legal work to draft a petition to the US SEC for a crowdfunding exemption. After the campaign met its funding goal, interns Aroma Sharma and Kathleen Kenney researched and wrote the petition.
- July 2010: SEC posts the SELC crowdfunding exemption petition as File 4-605. The petition proposed a \$100,000 cap on every crowdfunding offering, and a \$100 cap on individual investments.
- December 2010: A new crowdfunding exemption petition is registered with the SEC, by the lobbying group Startup Exemption. It proposed exemption caps of \$1 million for the total crowdfunding offering and \$10,000 or 10% of income for each individual investment.
- Early 2011: The Startup America initiative was launched by the White House to celebrate, inspire, and accelerate high-growth entrepreneurship. Congress hears testimony about the pros and cons of crowdfunding.
- November 2011: The House passes several bills aimed at economic revitalization. These include the Small Company Capital Formation Act, Entrepreneur Access to Capital Act, and Access to Capital for Job Creators Act. The Entrepreneur Access to Capital Act was introduced by Patrick McHenry (a Republican from North Carolina) and revised in collaboration with Carolyn Maloney (a Democrat from New York). It was endorsed by the White House and was the first bill to create a regulatory exemption for crowdfunded securities.
- December 2011: Representative Stephen Lee Fincher (a Republican from Tennessee) introduces the Reopening American Capital Markets to Emerging Growth Companies Act to relieve companies with annual revenue of less than \$1 billion from some Sarbanes-Oxley Act compliance requirements. The bill was referred to the House Financial Services Committee.
- Late 2011-2012: Two Senate bills focused on a new crowdfunding exemption

are proposed: the Democratizing Access to Capital Act (proposed by Scott Brown, a Republican from Massachusetts) and the CROWDFUND (Capital Raising Online While Deterring Fraud and Unethical Non-Disclosure) Act (proposed by Jeff Merkley, a Democrat from Oregon). These were referred to the Senate Banking Committee, which took no action on them until March 2012.

- March 2012: House Majority Leader Eric Cantor introduced the Jumpstart Our Business Startups (The JOBS Act). After some debate and revision, the new JOBS Act passed the House on March 8. On March 13, the same day that the Act was placed on the Senate legislative calendar, Senator Jeff Merkley introduced a revised version of his CROWDFUND bill, cosponsored by Michael Bennet (a Democrat from Colorado), Scott Brown, and Mary Landrieu (a Democrat from Louisiana). On March 19, during the JOBS Act's debate in the Senate, Merkley, Bennet, and Brown amended the legislation. The revision passed the Senate on March 22, and after some debate passed the House on March 27.
- April 5, 2012: The JOBS Act was signed into law.

### **Annex 3. A summary of the JOBS Act**

The JOBS Act consists of seven parts, each titled as follows:

- Title I. Reopening American Capital Markets to Emerging Growth Companies
- Title II. Access to Capital for Job Creators
- Title III. Crowdfunding
- Title IV. Small Company Capital Formation
- Title V. Private Company Flexibility and Growth
- Title VI. Capital Expansion
- Title VII. Outreach on Changes to the Law

The following brief descriptions explain the core policy changes introduced through each of the titles.

- **Title I. Reopening American Capital Markets to Emerging Growth Companies:** This has also been called the ‘IPO On-Ramp for ‘Emerging Growth Companies.’<sup>xxxix</sup> It responds to a trend of declining Initial Public Offerings (IPOs) over the past few decades and creates special rules for “emerging growth companies” (EGC). These are companies with less than \$1 billion in annual revenues that will be exempt (or partially exempt, for a period of time) from certain disclosures that were thought to deter companies from choosing to go public. It allows brokers to issue verbal, hard copy, or electronic research on an EGC without constituting an offer to sell securities, thereby loosening marketing standards for EGC’s seeking to raise capital. An EGC is also permitted to file a confidential IPO registration statement with the SEC that must be made public at least 21 days before it begins actively promoting the sale of its offering, and can ‘test the waters’ with certain qualified buyers to gauge interest in the offering.
- **Title II. Access to Capital for Job Creators:** The second part of the JOBS

Act addresses rules governing certain private offerings. Historically, a Regulation D, Rule 506 offering has been exempt from SEC registration provided that the offering is not publicly advertised and that the purchasers are largely qualified institutions or “accredited” investors – those whose net worth is greater than \$1 million (excluding a primary residence) or whose individual income exceeded \$200,000 (\$300,000 for couples) for the past two years with the expectation for that level of income to continue in the current year. Title II called for the SEC to lift the ban on mass marketing these offerings, provided that the issuer reasonably believes and has taken reasonable steps to verify that the buyers of the private securities are in fact accredited.

- **Title III. The Crowdfund Act:** This is called the “Capital Raising Online While Deterring Fraud and Unethical Disclosure Act of 2012” or the “CROWDFUND Act”. Section 302, titled “Crowdfunding Exemption,” defines terms under which transactions of \$1.0 million or less are exempt from certain registration requirements, thus allowing companies to easily raise up to \$1.0 million per year. However, it establishes maximum annual purchase limits for crowdfunded securities based on income and net worth thresholds of the investor and states that the securities must be purchased through a “funding portal.” The purchase limits are as follows: The greater of \$2,000 or 5% of annual income or net worth, if either the annual income or the net worth of the investor is less than \$100,000; If the annual income or net worth of the investor is greater than \$100,000, the investor can purchase up to 10% of either of those amounts with an annual cap not to exceed \$100,000. Section 304 requires the SEC to create rules that would relax the current laws requiring the newly defined intermediary, “funding portals,” to register as broker-dealers, provided that they remain subject to SEC authority—instead they would register as funding portals, not broker dealers. Intermediaries must register with the SEC as either a broker or a funding portal as well as with “any applicable self-regulatory organization,” but as the only self-regulatory body is

FINRA, the portal must register with FINRA. A “Funding Portal” is defined in this title, revising the Securities Exchange Act of 1934, section 3(a)(80) with the following language: “The term “funding portal” means any person acting as an intermediary in a transaction involving the offer or sale of securities for the account of others, solely pursuant to section 4(6) [15] of the Securities Act of 1933 (15 U.S.C. 77d [16]), that does *not*: Offer investment advice or recommendations; Solicit purchases, sales, or offers to buy the securities offered or displayed on its website or portal; Compensate employees, agents, or other persons for such solicitation or based on the sale of securities displayed or referenced on its website or portal; Hold, manage, possess, or otherwise handle investor funds or securities; or Engage in such other activities as the Commission, by rule, determines appropriate.” The Funding Portal must provide disclosures, including disclosures pertaining to risk and other investor education materials that the SEC may, by rule, deem appropriate. The portal must ensure that each investor review the investor education information and understand that they could lose their entire investment. Portals must also administer questions demonstrating that the investor understands the type of high risk they are taking by investing in startups and small firms and also that these investments generally are not liquid. The portal is also required to assist in protecting investors from fraud committed by Issuers by taking the following actions: Conducting background checks (with the SEC enforcement division); Within 21 days provide the SEC with any information provided by the issuer; Ensure that offering proceeds are only provided to the issuer when aggregate capital raised is equal to or greater than the target offering amount; Ensure that the annual investor investment limits have not been exceeded; Take steps to insure the privacy of the information collected as determined by the SEC in future regulations; Not compensate promoters, finders, or lead generators for providing the portal with the personal identity of potential investors; Prohibit its officers, directors, or partners from having any

financial interest in an issuer using its services; Meet other requirements as the Commission may, by rule, prescribe for the protection of investors

In order for Issuers to be eligible for the crowdfund exemption, Issuers must file with the commission and provide to investors, their funding portal, and potential investors key pieces of information. This required information includes basic information as well as descriptions of the business, business plan, and the financial condition of the issuer and past offerings. The stated use and purpose of the proceeds, including the target amount and deadline for reaching the targeted amount, must be provided along with regular updates during the raising process. This section also establishes audited financials and income tax reporting requirements based on the target amount. Most important, the Issuer must provide a description of the ownership and capital structure of the issuer, how the shares may be affected by other securities in the capital structure or diluted, and how the securities offered are being valued and risks to purchaser associated with being minority shareholders. Finally, the section establishes the liability of Issuers for making fraudulent statements or omitting material facts in connection with an offering. This section also restricts the transfer of crowdfunded securities except under four conditions: a transfer to the Issuer, a transfer to an accredited investor, a transfer as part of a registered security offering, or a transfer to a family member as part of a divorce proceeding or as a result from the death of a family member. The SEC is then tasked with designing rules that govern the disqualification of issues, brokers, and funding portals, however as mentioned before, as of the writing of this paper, the SEC had missed the deadline for issuing these rules. Although the portal cannot receive commission, which restricts their profitability, the portal or platform is permitted to co-invest in the securities offered on their site. Furthermore, this section allows those who provide ancillary services, such as lawyers and accountants, to bring investors to the intermediary without registering as a broker-dealer. Section 305, Relationship with

State Law, limits the authority of the SEC to interfere with state security examiner's ability to enforce or to examine funding portals. It also establishes that the exemption from state requirements applies only to registration, documentation, and offering requirements, and then details the condition that allows states to charge fees on the issuance of crowdfunded securities.

- **Title IV. Small Company Capital Formation:** This section has also been called Regulation A+, given that it updates pre-existing Regulation A (pertinent to the 1933 Securities Act). Initially, the Regulation A exemption applied to offerings up to \$5.0 million, but a recent amendment as part of the JOBS Act changed that limit to \$50.0 million sold within a 12-month period. Under this new amendment as part of the JOBS Act, the issuer will have to prepare annual audited financials, and the SEC has the right to request more detailed information regarding business operation, financial condition, corporate governance principals, and use of investor funds. This information would be made available to the public. Also, the SEC will, no later than two years from the date of enactment of the JOBS Act, review the proposed \$50.0 million offering size to insure it is still appropriate.
- **Title V. Private Company Flexibility and Growth:** Title V modifies the Securities Exchange Act of 1934 regarding the threshold requirements for registration. Under old provisions of the Exchange Act, if a company had fewer than 750 shareholders and less than \$1.0 million in assets, the firm was exempt from registration. Those limits were amended to less than \$10.0 million in assets or either of the following shareholder thresholds: more than 2,000 shareholders or more than 500 non-accredited investors. For purposes of the shareholder thresholds discussed in 501, Section 502 excludes employee stock compensation plans from threshold counts, which is important for start-up companies that often use this compensation method.

- **Title VI. Capital Expansion:** Title VI focuses primarily on banks and is parallel in scope to Title V as it applied to small companies. The rationale behind this act is that freeing up small banks from expensive reporting requirements allows these banks to lend more aggressively and better support local small businesses.

#### **Annex 4. Proposed rules for Title IV of the JOBS Act<sup>xl</sup>**

Congress directed the SEC to issue rules to implement the crowdfunding provisions of the JOBS Act. When the Securities and Exchange Commission finally unveiled “Regulation Crowdfunding” in late 2013, the proposed regulations included the following highlights that build on the existing law:

- Eligible businesses can raise up to \$1 million through one or more equity crowdfunding offerings during a 12-month period. These securities offerings are exempt from further SEC regulation, as long as the offering is conducted over the internet through a registered intermediary or “funding portal” and complies with the provisions of Regulation Crowdfunding. Securities that are sold through a crowdfunding offering are subject to a one-year holding period, during which time investors cannot trade or sell the securities on the secondary market.
- Graduated financial disclosure requirements are to be based on the size of the offering. Issuers offering securities in the amount of \$100,000 or less are only required to file income tax returns for the most recently completed year and financial statements certified by the principal executive officer. Those offering between \$100,000 and \$500,000 must file financial statements reviewed by an independent public accountant. Issuers offering greater than \$500,000 of securities must file audited financial statements prepared in accordance with GAAP.
- Regardless of size, all issuers are required to disclose certain information about the business, including information regarding the company’s current business plan; a description of the financial condition of the company and anticipated use of the offering proceeds; information about officers, directors, and owners of 20% or more of the company; the target offering amount and deadline for reaching that target; the price of the securities and the method used to determine the price; and relevant risk factors. The SEC has proposed that all issuers file these mandated disclosures on the EDGAR

electronic filing platform using a new "Form C." Issuers will also be required to file annual reports with the SEC that they must make available to all investors. This obligation continues until the issuer becomes a reporting company (files quarterly, annual and periodic reports like an NASDAQ or NYSE company), all crowd-funded securities are redeemed or bought by another party or the issuer goes out of business.

- Over the course of a 12-month period, individual investors are permitted to invest in businesses through registered intermediaries, referred to as "crowdfunding portals," subject to certain aggregate investment limits based on the investor's annual net income or net worth. If an individual investor's annual net income or net worth is less than \$100,000, that individual would be permitted to invest \$2,000 or 5 % of their annual income or net worth, whichever is greater. If an individual investor's annual net income exceeds \$100,000, that individual would be permitted to invest up to 10% of their annual income or net worth, up to a maximum of \$100,000 of securities purchased through crowdfunding.
- Other requirements include the electronic delivery of certain investor education materials and regulations related to the conduct and compensation of the funding portals.

## **Annex 5. April 2014 Title IV recommendations from the SEC Investor Advisory Committee<sup>xli</sup>**

Public comment on the SEC's proposed Title IV rules closed on February 3, 2014.<sup>xlii</sup> These show that the proposed rules met with strong criticism from concerned investors, individuals, businesses, and state regulators. Investors and businesses generally took issue with the proposed investment limitations, the \$1 million offer cap, and the potentially burdensome compliance costs and disclosure requirements. State securities regulators, on the other hand, voiced concerns over the risk of fraud and insufficient investor protection mechanisms.

The Investor Advisory Committee considered these comments and clearly sided with the regulators in making six recommendations, including the following:<sup>xliii</sup>

- There should be a limit to investor exposure to losses by further limiting the annual amount that can be invested by non-accredited investors in crowdfunding offerings “...to avoid investor concentration in start-ups as an asset class.”
- Rules should require portals to collaborate to ensure that investors can't “portal-hop” and further concentrate investments in start-ups.
- Rules should allow portals to reject investors and offerings “that they believe could pose an undue compliance or fraud risk.”
- Rules should be introduced to “...take further steps to ensure that educational materials clearly convey the required information and are reviewed and, to the degree possible, understood by investors.”
- Rules should force crowdfunding portals to provide the disclosures and educational materials to the investors electronically and not just by pointing to certain links to pages on the website.
- Rules should “...require crowdfunding offerings to be integrated with offerings in reliance on a separate exemption where needed and appropriate to prevent evasion of regulatory requirements.”

## Annex 6. Examples of state-level crowdfunding legislation

A number of states have already developed legislation for crowdfunding:

- The *Invest Kansas Exemption* was adopted in spring 2011 by the Kansas Securities Commission. It made Kansas the first state in the United States to allow non-accredited investors to invest up to \$1,000 each for a grand total of \$1,000,000. Investors must be state residents and the security issuer must be a business or organization “formed under the laws of the state of Kansas and registered with the secretary of state.” Few other conditions were present, such that the red tape requirements are low even though the cap is also low.
- The *Invest Georgia Exemption* was adopted in November 2011 by the Georgia State Securities Division. It is similar to the law in Kansas but increased the individual contribution cap to \$10,000 per person. According to the regulation, each investor must be “a natural person residing in the State of Georgia, or a corporation, trust, partnership, association, or any other legal entity duly organized under the laws of the State of Georgia.” There are few additional conditions.
- Michigan passed its crowdfunding bill on December 30, 2013. It matches Georgia’s cap per contributor, at \$10,000 per individual, and caps the aggregate fundraising amount at either \$1 million or \$2 million depending on an audit compliance protocol similar to Washington’s proposed law detailed below. It has high red-tape demands, though, requiring compliance to a litany of preconditions (like filing, audits, disclosure statements, quarterly reports, and fees).
- Washington state’s legislation, proposed in April 2013, sets an aggregate fundraising limit at \$1,000,000 and limits the contribution of any individual investor at the greater of \$2,000 *or* 5% of net annual income (with the condition they make less than \$100,000 annually) *or* 10% of their net annual income or net worth if either is greater than \$100,000 (with the condition that the total amount invested not

exceed \$100,000). Crowdfunding administrators also have a fee to pay of \$300, within 15 days of the first sale to the state (ostensibly for filing paperwork), and have to comply with similar conditions required by Michigan (including quarterly reports to all investors including executive officer and director compensation and company financials).

## **Annex 7. Some commercial real estate firms using Title II of the JOBS Act**

A number of firms have emerged to offer crowdfunding opportunities under Title II of the JOBS Act. These include the following examples:

- Fundrise ([www.fundrise.com](http://www.fundrise.com)) offerings provide shares or equity ownership in various properties, including public offerings available to local investors and private offerings available to accredited investors. According to the Washington Post,<sup>xliv</sup> “Developers have used the platform to close investments for more than a dozen projects totaling more than \$10 million. Money is currently being raised for four projects, in Austin, Texas; San Francisco; Philadelphia and Brooklyn, N.Y. When those projects close, the total raised through Fundrise could top \$12 million.”
- Realty Mogul ([www.realtymogul.com](http://www.realtymogul.com)) provides a marketplace for accredited investors to pool money online and buy shares of pre-screened real estate investment. The startup launched in 2013 and in its first year claimed to have invested over \$14 million from 6,000 members in projects worth over \$100 million.<sup>xlv</sup>
- RealtyShares ([www.realtyshares.com](http://www.realtyshares.com)) is an online investment platform that uses crowdfunding to pool investors into private real estate investments. Calling itself a “LendingClub for Real Estate”, RealtyShares gives accredited Investor members access to extensive information on a variety of investment properties and opportunities to invest as little as \$5000 into each such property. In its first year of operation, the company claims to have helped fund 26 projects in eight different states across the U.S.A, valued at around \$70 million.<sup>xlvi</sup>
- CrowdStreet ([www.crowdstreet.com](http://www.crowdstreet.com)) is an Oregon-based fundraising platform connecting accredited investors with professionally-managed real estate investments. CrowdStreet features both equity and debt investment opportunities, including multifamily, retail, office, industrial and land opportunities. In addition to traditional direct

investments. Its first project was a senior housing initiative in Bloomington, Indiana, which raised \$218,000 within days of listing.<sup>xlvi</sup>

- iFunding ([www.ifunding.co](http://www.ifunding.co)) is a real estate crowdfunding platform that allows individual investors to select and make direct investments in pre-vetted institutional real estate assets. In early 2014 it closed on a \$250 million condominium tower on Fulton Street in Manhattan, having raised \$8 million for the purchase through crowdfunding.<sup>xlvi</sup>
- Prodigy Network ([en.prodigynetwork.com](http://en.prodigynetwork.com)) is known for raising \$171 million in \$20,000 increments for a mixed-use skyscraper development under way in Bogotá, Colombia. It has also led the way with crowdfunding in the USA, raising \$24.5 million in equity from 48 investors to buy adowntown Manhattan building (84 William St).<sup>xlvi</sup> Currently, Prodigy deals by phone, email or in person with potential investors, offering Real Estate Participations (REPs) for interested investors. The minimum REP investment will vary depending on the project but usually ranges between \$20,000 and \$250,000. REPs are tailored for Non-US investors outside the United States, or Accredited Investors inside the United States.

## **Annex 8. Legal and practical engagement of the Colombian Fiduciaria<sup>1</sup>**

Trusts are an important vehicle for fostering economic activity in Colombia. Article XI of the Commerce Code provides foundational rules for thinking about this vehicle. Article 1226 provides for the 'Definition of a Commercial Trust', denoting such as a contract whereby a person (called a trustor or settlor) transfers one or more specified assets to another (called a trustee), who undertakes the obligation to manage or sell it (them) to fulfill a particular purpose set by the settlor for the benefit of the latter or a third party called beneficiary or trustee. The law holds that "Only credit entities and trust companies specially authorized by the Colombian Banking Superintendence Office (Superintendencia Bancaria) may be trustees." Initially, Colombia's Law 45 of 1923 permitted banks to provide trust activities. Law 45 of 1990 changed this arrangement, obliging the creation of stand-alone companies (fiduciarias) to manage or administer third party trusts ("fideicomisos").

These funds can be one of three types: *fiducia mercantil* (involving a transfer of ownership and the creation of an autonomous trust for funds/goods, which is managed by the fiduciaria on behalf of the beneficiary); *encargo fiduciario* (where the fiduciaria administers the funds/goods on behalf of the owner without any transfer of ownership or creation of autonomous trust) and *fiducia publica* (which are similar to *encargo fiduciario* but involving a public entity).

Trusts like these can be established for several reasons and include collective investments and other investment funds with "specific destination" (e.g. public pension funds), securitization vehicles (e.g. for securitizations of construction projects, bank loans, or future cash flows of local/national government), construction/property development/infrastructure projects, restructured corporate and municipal loans, liquidation of private and public companies, administration of housing subsidies, inheritance and life insurance contracts, and collateral trusts ("fiducia en garantía").

The Superintendencia Financiera classifies fiduciary activities into the following categories: inversión, inmobiliaria (payments and collections for

construction projects etc.), administración (payments and collections for other trusts such as those for inheritance, property, securitizations and restructured loans etc.), seguridad social (administration and investments of trusts/funds related to social security, including FPV), and garantía y otros (all others, including fiducia en garantía).

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<sup>i</sup> The following are good reference points for such work: Belleflame, P., Lambert, T., and Schweinbacher, A. (2011). 'Crowdfunding: Tapping the Right Crowd' in *International Conference of the French Finance Association (AFFI), May 11-13, 2011.*; Gerber, E., Hui, J., and Kuo, P-Y. (2012). 'Crowdfunding: Why People Are Motivated to Post and Fund Projects on Crowdfunding Platforms', *ACM Conference on Computer Supported Cooperative Work* ([http://www.juliehui.org/wp-content/uploads/2013/04/CSCW\\_Crowdfunding\\_Final.pdf](http://www.juliehui.org/wp-content/uploads/2013/04/CSCW_Crowdfunding_Final.pdf)); Howe, J. (2008). *Crowd Sourcing: Why the Power of the Crowd is Driving the Future of Business*. New York: Crown Publishing; Hui, J., Greenberg, M., and Gerber, E. (2014) *Understanding the Work of Crowdfunding in Communities*, CSCW 2014, Baltimore ([http://egerber.mech.northwestern.edu/wp-content/uploads/2013/10/2014\\_CrowdfundingWorkCommunities\\_CSCW\\_Accepted.pdf](http://egerber.mech.northwestern.edu/wp-content/uploads/2013/10/2014_CrowdfundingWorkCommunities_CSCW_Accepted.pdf)).

<sup>ii</sup> See Laura Kolodny's January 2014 article on this in the Wall Street Journal, titled 'Indiegogo Raises \$40M in Largest Venture Investment Yet for Crowdfunding Startup' (<http://blogs.wsj.com/venturecapital/2014/01/28/indiegogo-raises-40m-in-largest-venture-investment-yet-for-crowdfunding-startup/>).

<sup>iii</sup> See Kickstarter's homepage: <https://www.kickstarter.com/?ref=nav>

<sup>iv</sup> Defined in the 1946 U.S. Supreme Court Verdict of *SEC v. W. J. Howey Co.*

<sup>v</sup> Burgett, B.L., and McDonald, J.R. (2013.). 'Democratizing Commercial Real Estate Investing: the Impact of the JOBS Act and Crowdfunding on the Commercial Real Estate Market' *Masters Thesis*, Massachusetts Institute of Technology September. Boston: MIT, pp.6-7.

<sup>vi</sup> Remarks by the President at the JOBS Act Bill Signing. <http://www.whitehouse.gov/the-press-office/2012/04/05/remarks-president-jobs-act-bill-signing>

<sup>vii</sup> Cited in the Forbes article 'The Politics of Crowdfunding' on 13 May 2014.

<http://www.forbes.com/sites/wilschroter/2014/05/13/the-politics-of-crowdfunding/>

<sup>viii</sup> See commentary in a February 2014 article titled 'The JOBS Act and the Law of Unintended Consequences.' <http://www.crowdfundinsider.com/2014/02/32527-jobs-act-law-unintended-consequences/>

<sup>ix</sup> The recommendations are available at <http://www.sec.gov/spotlight/investor-advisory-committee-2012/investment-adviser-crowdfunding-recommendation.pdf>

<sup>x</sup> See the article 'Crowdfunding Update: Still Stuck' by Peter I. Dunn on May 15, 2014.

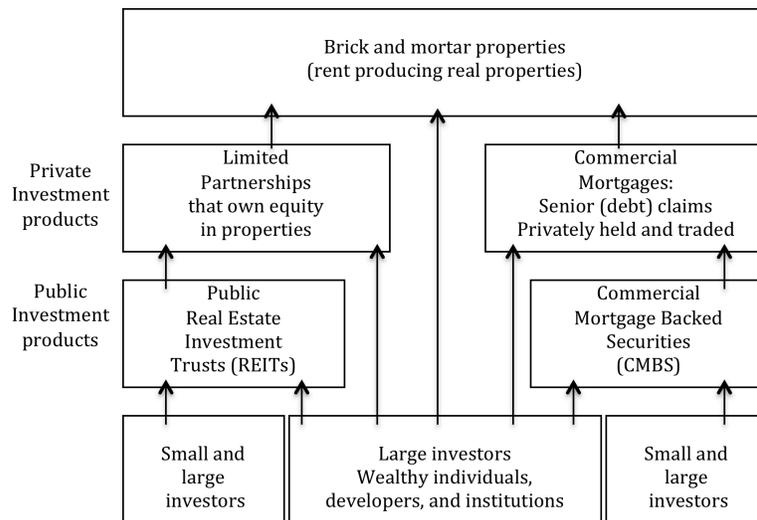
<http://www.mondaq.com/unitedstates/x/313896/Securities/Crowdfunding+Update+Still+Stuck>

<sup>xi</sup> Investors making less than \$50,000 a year would be limited to \$2,000 in investments. Those making up to \$100,000 year would be limited to \$4,000. Investors making more than \$100,000 would be limited to invest only up to 8% of their income.

<sup>xii</sup> In this respect, an advocacy group called Crowdfund Capital Advisors notes that, "There seems to exist in certain regulatory circles... a perception that Crowdfund Investing (CFI), when it comes on-line, will be rife with fraud. But this sky-is-falling mentality is unfounded and points to no structural or design problems with Title III and no data to support this conclusion. Contrary, the available data in markets where equity and debt crowdfunding currently exist (for example, Australia and the UK) supports the national imperative for crowdfunding and undermines their conclusion. The reason for this is that crowdfunding is based on one of the most powerful tools today for weeding out fraud, social media" (<http://crowdfundcapitaladvisors.com/resources/26-resources/120-crowd-detects-fraud.html>). See also the article 'Crowdfunding Fraud: How Big is the Threat?' on March 20, 2014. <http://www.crowdfundinsider.com/2014/03/34255-crowdfunding-fraud-big-threat/>

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- <sup>xiii</sup> See Salvador Briggmann's article on this, titled "Top 10 Real Estate Crowdfunding Websites". <http://www.crowdcru.com/top-real-estate-crowdfunding-websites/>
- <sup>xiv</sup> See the June 11, 2014 article in the Wall Street Journal on this topic, titled "The real estate sector moves crowdfunding beyond the trinkets." <http://online.wsj.com/articles/real-estate-sector-moves-crowdfunding-beyond-the-trinkets-1402526777>
- <sup>xv</sup> See the June 11, 2014 article in the Wall Street Journal on this topic, titled "The real estate sector moves crowdfunding beyond the trinkets." <http://online.wsj.com/articles/real-estate-sector-moves-crowdfunding-beyond-the-trinkets-1402526777>
- <sup>xvi</sup> The UBS Real estate markets research brief on 31 January 2014 is an example. It is titled 'Crowdfunding—The next revolution in real estate financing' and notes (on page 4) that "there are only approximately 8.5 million accredited investor households out of the roughly 115 million households in the US. Crowdfunding [thus gives] broad reach into untapped pools of investors." UBS. (2014). 'Crowdfunding—The next revolution in real estate financing' *UBS CIO WM Research*, 31 January 2014.
- <sup>xvii</sup> Wolff, E.N. (2010). 'Recent trends in household wealth in the United States: Rising debt and the middle-class squeeze—an update to 2007.' *Working Paper, Levy Economics Institute, No. 589*. New York: Bard College, pages 36 and 48.
- <sup>xviii</sup> Ibid.
- <sup>xix</sup> Hartzell, Hekman, and Miles argue that investment real estate offers a very positive addition to any portfolio: "A portion of the investment allure of real estate stems from its hypothesized ability to generate improved risk-adjusted returns when added to a stock and bond portfolio. The logic is straightforward Markowitz [1959] with the attractiveness of real estate a function of its expected return, the standard deviation of its expected return and the correlation of its expected return with the expected returns on the stocks and bonds currently held in the portfolio." Hartzell, D., Hekman, J., and Miles, M. (1986). 'Diversification Categories in Investment Real Estate' *AREUEA Journal* Vol.14:2, 230-254, p. 232.
- <sup>xx</sup> Burgett, B.L., and McDonald, J.R. (2013.). 'Democratizing Commercial Real Estate Investing: the Impact of the JOBS Act and Crowdfunding on the Commercial Real Estate Market' *Masters Thesis*, Massachusetts Institute of Technology September. Boston: MIT, pp.38-48.
- <sup>xxi</sup> Burgett and McDonald (2013, cited earlier) argue that most equity and debt avenues for financing real estate benefits access for wealthier individuals and organizations, as in the following figure (see page 42).

**Diagram of the USA Real Estate Investment System**



For a full discussion of these financing options and the idea that smaller “unaccredited” investors enjoy less access, see Geltner, D. (2007) *Commercial Real Estate Analysis and Investments*. Mason, Ohio: Cengage Learning.

<sup>xxii</sup> Burgett, B.L., and McDonald, J.R. (2013.). ‘Democratizing Commercial Real Estate Investing: the Impact of the JOBS Act and Crowdfunding on the Commercial Real Estate Market’ *Masters Thesis*, Massachusetts Institute of Technology September. Boston: MIT, pp.43-44. See also the Pension Real Estate Association, <http://www.prea.org>.

<sup>xxiii</sup> The UBS Real estate markets research brief on 31 January 2014 is an example. It is titled ‘Crowdfunding—The next revolution in real estate financing’ and notes (on page 4) that “there are only approximately 8.5 million accredited investor households out of the roughly 115 million households in the US. Crowdfunding [thus gives] broad reach into untapped pools of investors.” UBS. (2014). ‘Crowdfunding—The next revolution in real estate financing’ *UBS CIO WM Research*, 31 January 2014.

<sup>xxiv</sup> See the firm’s website, <http://en.prodigynetwork.com>

<sup>xxv</sup> See the January 2013 report on this topic in Business Week, titled ‘Crowdfunding for Real Estate: Buy a Slice of a Skyscraper’ (<http://www.businessweek.com/articles/2013-01-24/crowdfunding-for-real-estate-buy-a-slice-of-a-skyscraper>).

<sup>xxvi</sup> Visit the hotel at <http://www.hotelexebacata95.com/EN/>

<sup>xxvii</sup> As described in the article, ‘In defense of crowdsourcing and crowdfunding’.  
<http://www.archdaily.com/499150/rodrigo-nino-in-defense-of-crowdsourcing-and-crowdfunding/>

<sup>xxviii</sup> Article 335 of the Constitution explicitly promotes “the democratization of credit”.

<sup>xxix</sup> A 2006 World Bank paper describes this clearly, noting that, “Even though the legal concept of a trust/fiduciary contract exists in other countries, fiduciarias have no direct counterparts (including in Chile, Mexico and Spain) and their application and interpretation are very different. Their activities are instead allocated to different types of entities – for example, banks are typically responsible for trust and custody services, specialized fund management companies are responsible for collective investment schemes, while some other activities (e.g. payment of public pensions) are not normally associated with financial institutions.” De La Cruz, J. and Stephanou, C. (2006). *Financial System Structure in Colombia: A Proposal for a Reform Agenda*. World Bank Policy Research Working Paper 4006, September 2006. Washington, D.C.: World Bank, p.24.

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<sup>xxx</sup> De La Cruz, J. and Stephanou, C. (2006). Financial System Structure in Colombia: A Proposal for a Reform Agenda. World Bank Policy Research Working Paper 4006, September 2006. Washington, D.C.: World Bank, p.25.

<sup>xxx</sup><sup>i</sup> Given these requirements, the trust company must apply its internal control processes to evaluate, assess, and verify aspects such as: (i) That the land on which the project will be developed has been acquired or contributed definitely and that transfers fulfill the formalities of the law for such type of negotiations; (ii) That the transfer of real estate does not have any legal problems that may impede or prevent the transfer of the property from resulting real estate units to future acquirers; (iii) That there is not diversion of resources obtained to finance the project; (iv) That the equilibrium point set forth by the settlor or participant does not jeopardize the viability of the project; (v) That technical and legal conditions for the project to be completed are given before allowing builders to have the resources of future buyers.; (vi) That construction licenses and permits necessary for the development of the work are consistent with relevant legal requirements; (vii) That the developer meets minimum levels of insolvency, technical, administrative, and financial capacity according to the magnitude of the Project; and (viii) That there is certainty about obtaining the necessary credits for the execution of the work.

<sup>xxx</sup><sup>ii</sup> There is often a construction auditor, independent from the developer, who looks after the construction works and timeline.

<sup>xxx</sup><sup>iii</sup> As discussed in the December 23, 2013 article 'Prodigy Network Bets Big on Crowdfunding Commercial Real Estate.' <http://www.crowdfundinsider.com/2013/12/28855-prodigy-network-bets-big-crowdfunding-commercial-real-estate/>

<sup>xxx</sup><sup>iv</sup> FTI Consulting is the fund administrator. Appleby Global is the escrow agent for the offshore fund and provides independent third party directorship services. Pillsbury Winthrop Shaw is the escrow agent for the domestic feeder. FTI Consulting manages the accounting and reporting for the investment and ensures that funds are contributed in accordance with the offering documents. Appleby and Pillsbury ensure that funds are only released from escrow after enough financing has been obtained to close on the property. Fees associated with these arrangements include a 2% asset management fee that is charged annual based on the amount of funds contributed. A 3% development fee is charged for development projects based on the total cost of the project.

<sup>xxx</sup><sup>v</sup> The approach is being developed in conjunction with professors at Columbia University and addresses conventional questions about investing in real estate (that focus on the value of property, potential value of finished construction, and risks to project completion) as well as more novel questions about calculating risks and rewards of investing with the crowd (including whether the full investment totals are raised, if the project attracts more crowd support than envisaged, and more).

<sup>xxx</sup><sup>vi</sup> As discussed in the December 23, 2013 article 'Prodigy Network Bets Big on Crowdfunding Commercial Real Estate.' <http://www.crowdfundinsider.com/2013/12/28855-prodigy-network-bets-big-crowdfunding-commercial-real-estate/>

<sup>xxx</sup><sup>vii</sup> One blog posting was particularly disparaging of this idea, describing Colombia sarcastically as "a nation that has given the world so many good ideas." See

<http://www.internationalappraiser.com/2013/02/isnt-crowdfunding-old-syndication-game.html>

<sup>xxx</sup><sup>viii</sup> See the Financial Advisory Magazine article on the topic, titled 'SEC advisory committee wants tighter crowdfunding rules'. <http://www.fa-mag.com/news/sec-advisory-committee-wants-tighter-crowd-funding-rules-17580.html>

<sup>xxx</sup><sup>ix</sup> <http://www.forbes.com/sites/realspin/2013/10/08/the-jobs-act-isnt-all-crowdfunding/>

<sup>xl</sup> See the SEC website for full rules: <https://www.sec.gov/rules/proposed/2013/33-9470.pdf>

<sup>xli</sup> The recommendations are available at <http://www.sec.gov/spotlight/investor-advisory-committee-2012/investment-adviser-crowdfunding-recommendation.pdf>

<sup>xlii</sup> Public comments are available at <https://www.sec.gov/comments/s7-09-13/s70913.shtml>

<sup>xliii</sup> For full detail of the recommendations, see <http://www.sec.gov/spotlight/investor-advisory-committee-2012/investment-adviser-crowdfunding-recommendation.pdf>

<sup>xliv</sup> <http://www.washingtonpost.com/news/capital-business/wp/2014/01/31/fundrise-tops-10-million-mark-in-crowd-sourced-real-estate/>

<sup>xlv</sup> <http://techcrunch.com/2014/03/27/real-estate-crowdfunding-startup-realty-mogul-raises-9m/>

<sup>xlvi</sup> <http://techcrunch.com/2014/04/16/realtyshares-1-9m-general-catalyst/>

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<sup>xlvii</sup> <http://upstart.bizjournals.com/companies/startups/2014/04/24/crowdstreet-crowdfunding-tore-steen.html?page=all>

<sup>xlviii</sup> <http://www.rew-online.com/2014/01/07/ifunding-to-build-250-million-condo-tower-on-fulton-street/>

<sup>xlix</sup> <http://www.businessweek.com/articles/2013-01-24/crowdfunding-for-real-estate-buy-a-slice-of-a-skyscraper>

<sup>1</sup> De La Cruz, J. and Stephanou, C. (2006). Financial System Structure in Colombia: A Proposal for a Reform Agenda. World Bank Policy Research Working Paper 4006, September 2006. Washington, D.C.: World Bank, p.24